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SUBJECT: IMI - INVESTMENT CLIMATE STATEMENT 2005 - MALDIVES

REF: (A) 04 STATE 269486 (B) 04 STATE 250356

11. THE FOLLOWING IS THE INVESTMENT CLIMATE STATEMENT  
FOR MALDIVES FOR 2005.

INVESTMENT CLIMATE STATEMENT

MALDIVES

FEBRUARY 2005

OPENNESS TO FOREIGN INVESTMENT  
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12. Maldives is made up of over 1,190 islands, of which 198 are inhabited and 87 are exclusive resort islands. The local population is about 285,000, and over 600,000 tourists arrive annually. Over the past decade, real GDP growth averaged over 7.5 percent per year, powered mainly by growth in tourism and its spin-offs in transport, communication, and construction.

13. The Asian tsunami in December 2004 caused extensive economic losses to Maldives. Total damages are estimated at around \$470 million -- close to 62 percent of GDP. Most losses were concentrated in housing and tourism, with education, fisheries, and transport also heavily affected. Twenty inhabited islands were destroyed. A few resort islands also suffered extensive damage. Loss of life in the Maldives, however, was relatively low compared to other countries. An assessment by the multilateral development banks estimates Maldives will need about \$304 million to implement a recovery and reconstruction strategy. Tourism will remain the main driver of the economy in the post tsunami era, and tourism's recovery will be critical for Maldives to again achieve high growth rates. The island resorts, for the most part, experienced only minor damage and Maldives has already begun to market its status as a unique tourist destination intensively. Donor agencies forecast GDP growth will slow to 1 percent in 2005 compared with a pre-tsunami forecast of 7.5 percent. The main donor agencies have indicated their commitment to help Maldives in reconstruction. All reconstruction assistance in Maldives will be channeled through a Tsunami Relief and Reconstruction Fund set up by the Government. There may be commercial opportunities especially in the construction sector and in the supply of equipment in the post tsunami recovery program.

14. In the recent decades, Maldives has welcomed foreign investment. The lack of codified law and a predictable investment framework had, over time, dampened investor interest. This began to change with the passage of laws on foreign investment and the creation of institutions to deal with investment. The government of the Republic of Maldives introduced a Foreign Investment Services Bureau (FISB) in 1987, within the Ministry of Trade and Industries. Still the lack of a strong legal and procedural regime for investment and an over-reliance on negotiations makes the job of the FISB difficult and presents an added risk for investors. The FISB offers "one-stop shop" services to investors, and incentives, such as 100 percent foreign ownership, duty exemptions and no exchange controls or restrictions on repatriation of profits. At present, personal income taxes are not imposed, though banks' profits are taxed and a corporate profit tax is under consideration for the end of the decade. Domestic and international arbitration is available for dispute settlement.

15. Foreign investment is governed by Law 25/79, passed in 1979, which provides for an agreement between the government and an investor setting out terms and conditions. A Law of Contract governs

contractual relationships, and a separate law (no. 4/79) governs business and trading activities by foreign nationals. Investment agreements are for an initial period of 5 to 10 years for investments less than \$1 million, and can be renewed thereafter. For larger projects, terms are negotiable. Foreign investors qualify for import duty concessions as specified by the FISB.

16. The FISB plans to amend Law 25/79 with the help of the Foreign Investment Advisory Service (FIAS) of the World Bank Group to make foreign investment more transparent and speed up the approval process. Changes will include a licensing process whereby investors in FIAS-identified approved investment areas will be automatically issued a license. Investment in "restricted" and "approval with restrictions" areas will be reviewed by a Foreign Investment Board, which would be composed of government representatives, before licenses can be granted. Licenses will not have the time restrictions currently imposed on contracts.

17. Currently there are several foreign investments in Maldives, primarily in resort management, but also in accounting services, banking, telecommunications, air transport, courier services, and manufacturing.

18. The FISB encourages investment projects which: (1) are capital intensive; (2) enhance technology transfer; (3) introduce new skills and offer training to local employees; and, (4) are environmentally friendly. The FISB has identified several industries that offer potential for investors, which are summarized below.

Fisheries- fish processing is open to foreign investment, particularly for new technology and capital investment. Opportunities also exist for marine product development and aquaculture, including tropical fish farming and cultivation of seaweed, lobster, shrimp, reef fish and crab.

Financial- banking, accounting, and management consulting. The FISB is interested in bringing in more global banks (only HSBC is currently present). The present lack of adequate banking laws has deterred entry.

Transport and other services- development of air and sea transport including inter-atoll transport services, bunkering, transshipment, and passenger cruises. The 11 new resorts to open in 2005-2006 will also require transportation options from tourist arrival locations. The FISB plans to create a transshipment port in the north of the country for cargo bound for the east coast of India. Private funding is currently being sought, and construction should begin in 2005.

Infrastructure development- harbors and tourist resorts, residential/retirement islands for foreigners, health resorts, and time-share plans. There are two major development plans in the government's docket. The first is a consolidation of services and infrastructure of the 20 atolls around five regional centers, two of which have already been established. The second is a capital project to alleviate overcrowding in Male'. Reclamation and development of Hulhumale Island near Male' has already commenced. Hulhumale will house 50,000 people when the first stage of the project is completed in 30 years and 150,000 when all three stages are complete. Currently 1,000 people are in residence on the 465 acres of reclaimed land. Basic amenities, such as electricity, water and telecommunications, are being provided by the government at the same rates as Male'. The island eventually will be linked to the airport island via bridge and will offer 125 acres of duty-free shopping in a bid to increase Maldives' attraction for tourists. There will be opportunities in civil works in the above construction projects, road and bridge construction, domestic airport development, and seaport development. The government is also currently funding harbor-dredging projects for 103 islands on a contract basis.

19. Other sectors with potential opportunities include:  
Tourism: Opportunities exist in the entire range of services, including development and management of resorts, tourist activities, and land and sea transportation. The Government is reviewing bids for the development of 11 new resort islands.  
Telecommunications: Currently, Dhiraagu, jointly owned by Cable and Wireless and the Government of Maldives, is the main provider of telecommunications services. Their monopoly on cellular services will end soon when Wataniya International of Kuwait

commences operations in July 2005. There are two ISP providers: Focus Computers and Dhiraagu.

Information Technology: The FISB would like to establish a "technology island" of sorts for software development and other IT activities. While the connectivity infrastructure is not yet in place to support such an operation, it is felt that Maldives' climate, surroundings and pace of life would be attractive to software developers.

Other sectors include petroleum exploration; marine-based agriculture; handicrafts; export-oriented manufacturing, health services, tele-medicine, educational services, horticulture.

10. Sectors closed to investment: trading (i.e., shipping and transport of goods) and the production of any items illegal to import into Maldives.

#### CONVERSION AND TRANSFER POLICIES

11. There are no exchange controls or restrictions on currency movements. Repatriation of funds and profits is allowed, after local debts are settled.

12. Major international currencies can be bought and sold at banks and authorized moneychangers. Hotels and banks accept major credit cards and traveler's checks. Foreign-currency accounts are available through banks. The US dollar is the most widely used foreign currency and is accepted by small shops and taxi drivers in Male'.

13. The official exchange rate is set at 12.8 Rufiyaa to the dollar. The currency underwent a nine percent devaluation in July 2001 after staying at 11.77 Rufiyaa to the dollar for several years. The Maldivian currency is non-convertible and its true value cannot be determined. The Government has noted that it will need to review the exchange rate policy in the next few years in order to promote export diversification. The heavy dependence on imports is a constraint for management of exchange rate, though tourist receipts help maintain hard currency liquidity. During 2001-2002, businesses reported hard currency shortages and difficulty obtaining dollars at banks. Large fiscal deficits financed by Maldives Monetary Authority posed a potential threat to the fixed exchange rate system, and so the Government took steps to achieve fiscal consolidation during 2003, in part by expenditure control. Fiscal Deficit was 4.1 percent of GDP and 4.4 percent of GDP in 2003 and 2004 respectively. The Government intends that domestic financing of future deficits be carried out only by market sale of securities.

14. To enable more comprehensive and up-to-date control over public expenditures, initial actions have been taken to introduce a new public accounting system. Draft bills have been processed and are awaiting the endorsement of the President's Office before submission to the People's Majlis (Parliament), including a public finance bill, a public enterprise accountability bill, as well as amendments to the Audit Bill. The Government has also taken steps to expand the tax base and is planning to enact a business profit tax and a property rental value tax. Foreign reserves at end of 2004 were \$205 million, and were sufficient to finance 4.5 months of imports.

#### EXPROPRIATION AND COMPENSATION

15. According to the Law on Foreign Investment (25/79) the Government may, with or without any given notice, suspend an investment, either where the investor indulges in an act detrimental to the security of the country or where temporary closure is necessary in the interest of national security. If after due investigation, it cannot be concluded within 60 days of the temporary closure that the foreign investor had indulged in an activity detrimental to the security of Maldives, then the Government will pay fair compensation. Capital belonging to an investment that is closed for the above reasons may be taken out of the country in a mutually agreed manner. There does not appear to be any risk of expropriation in the near future.

#### DISPUTE SETTLEMENT

16. The sources of law in Maldives are its constitution, Islamic Sharia law, international law, and English common law, with the latter being more

influential in some areas, such as commercial law. Judges are appointed by the President and must be Muslims. There is a High Court in Male' and lesser courts, of a number to be determined by the President, in Male' and on other islands. There are no jury trials. The High Court serves as court of appeal and also handles any politically sensitive cases. There are also eight lower courts in Male' dealing with theft, debt and property cases. Ultimate appeal lies with the President.

17. Though legal practices are adequate with a number of overseas-trained lawyers, the judicial process is slow. The law on foreign investments guarantees the security of investments. Disputes involving investments below \$1 million can be referred to the courts of law in Maldives. Disputes over \$1 million can be referred for international arbitration.

18. Recognizing that the existing legal and commercial framework is underdeveloped and not always fully transparent or predictable, the government is promoting administrative reforms and formulating regulations dealing with labor, the environment and industry. In recent years, the People's Majlis legislative body has enacted a number of commercial laws, including the law of contract, the Negotiable Instruments of Law, and the Companies Act, and amended the tourism law to conditionally extend the 25-year resort lease period to 50 years. Maldives is not a member of the International Center for the Settlement of Investment Disputes (ICSID).

#### RIGHT TO PRIVATE OWNERSHIP AND ESTABLISHMENT

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19. There is little private ownership of land. Land reform currently under consideration may result in more trade and private ownership of property. Foreign investors are not allowed to own land, but are granted lease rights ranging up to 25 years, which can be later extended to 35 years for investments over \$10 million, or 50 years if 50 percent of the company's shares are floated on Maldives trading floor. Leases can be renewed at the end of their terms, but the formula for assessing compensation value of a resort at the end of a lease has not yet been developed.

#### PROTECTION OF PROPERTY RIGHTS

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20. Maldives lacks specific legislation to protect intellectual property rights (IPR) and has not signed on to international agreements and conventions, although it intends to comply with the provisions of the Trade-Related Aspects of Intellectual Property Rights (TRIPS) Agreement by end 2005. The Government is seeking assistance from the World Intellectual Property Organization (WIPO) to develop IPR laws and regulations. Consumers of computer software reportedly appreciate the value of genuine products, as pirated software programs often contain bugs and viruses.

#### EFFICIENT CAPITAL MARKETS AND PORTFOLIO INVESTMENT

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21. The financial sector in Maldives is very narrow and dominated by the banking sector. The banking sector consists of one publicly owned commercial bank -- the Bank of Maldives Plc -- and branches of four foreign owned commercial banks. HSBC, the only global bank present, set up operations in 2002. Non-bank financial institutions in the country consist of two insurance companies, a provident fund and a finance leasing company. All financial institutions currently operate under the supervision of Maldives Monetary Authority, which acts as the Central Bank.

22. Local sources of finance are limited in scope because of the small size of the capital market and the lack of instruments that are available in more developed nations. Certificates of Deposits are the only instruments to absorb excess liquidity from commercial banks. There are no financial instruments on offer to the public sector. The commercial banks provide short- and long-term credit to the private sector. No specialized financial institution exists to meet the investment needs of tourism, agriculture and fisheries. Non-performing loans are about 6 percent and the risk weighted capital adequacy ratio is high. Most foreign currency loans are made to foreign currency-earning tourist enterprises. The Maldives Monetary Authority has introduced an emergency liquidity facility for commercial banks. Banking supervision has been recently upgraded, moving toward international best practices.

123. The development of a stock market has been a policy objective of the Government of Maldives since the late 1990s and has been integrated in consecutive National Development Plans. As there is currently no organized capital market in Maldives, the Capital Market Development Section (CMDS) of the MMA is working towards creating the institutional mechanism to facilitate an organized market for raising capital required by the economy. A proposed Securities Bill would make provisions for the establishment of a regulatory framework for the capital market, the proposed capital market institutions and the licensing of financial intermediaries for the purpose of developing and regulating a capital market in Maldives. A small trading floor opened in Male' in April 2002 within the capital development department of the MMA. At present, the only investment opportunity available to the public is a limited number of shares in the Bank of Maldives and two other state-owned public companies - Maldives Transport and Contracting Company (MTCC) and the State Trading Organization (STO). There are plans to move to daily trading and expand into the islands, and the MMA is conducting an investor education program. There are hopes that the stock exchange will facilitate the development of a capital market. A leasing company, Maldives Finance Leasing Company Pvt. Ltd. was established in May 2002 as a collaborative venture between five domestic public and private sector entities and two international parties, in order to address the demand for long-term equipment financing from all sectors of the economy. The Asian Development Bank will support strengthening the financial sector to more effectively mobilize savings and fund long term development.

124. The newly formed Housing Development Finance Corporation is a government company designed to provide public housing loans with long repayment terms at favorable interest rates. The Company is also entrusted with drawing up the policy that plans and facilitates the use of land as an asset in Maldives, and to bring the necessary changes and the subsequent development of economic and financial mechanisms in the country, to incorporate this policy.

#### POLITICAL VIOLENCE

125. Maldives has a strong record of political stability resulting from the homogeneous nature of a society of one culture, one religion and one language, as well as the absence of political parties. The current President has been in office since 1979. The Government has begun a process of constitutional reforms to address recent calls for change and democracy. A Special Majilis (parliament) was established in May 2004 specifically to consider proposed amendments to the constitution. Reformists complain that reform programs are slow and insufficient. Rioting in September 2003 and August 2004 prompted the government to declare a state of emergency, which remained in effect for two months, and led to the detention of dozens of citizens including some members of the Special Majilis and the People's Majilis. They were released in December 2004. Parliamentary elections in January 2005 saw some reformists entering Parliament. Following the elections, the President presented detailed proposals for constitutional reform to the Parliament.

#### CORRUPTION

126. In 2002, Parliament passed a bill on the prevention and punishment of corruption. The provisions of the law cover definitions of bribery and improper pecuniary advantage and prescribe punishments. The law also outlines procedures for the confiscation of property and funds obtained through commission of the included offenses. It broadens the mandate of the Anti-Corruption Board, which previously extended only to government employees, to investigate corruption in the private sector.

#### OPIC AND OTHER INSURANCE PROGRAMS

127. Currently, OPIC does not operate in Maldives. Maldives is also not a member of the Multilateral Investment Guarantee Agency of the World Bank Group.

#### LABOR

128. Skilled and unskilled labor can be scarce, and

expatriate labor is allowed in order to meet shortages. There are an estimated 33,800 expatriate workers, mostly in tourism, construction and social and personal services. Using expatriate labor is equally or more expensive than local labor. Salaries are lower but travel and benefit costs make overall costs higher.

129. Wages in the private sector are usually set by contract between employer and employee and are generally based on rates for similar work in the public sector. Employment contracts usually specify work hours on a weekly or monthly basis. Employees are usually authorized 20 days of annual leave, 30 days of medical leave, 45 days' maternity leave, and 10 days of special annual leave for "extraordinary circumstances." There are no laws governing health and safety conditions; however, there are regulatory requirements that employers provide a safe working environment and ensure the observance of safety measures.

130. Maldives is not a member of the International Labor Organization. Although unions are not expressly prohibited, the Government does not recognize the right to form unions or the right to strike. Hence, labor actions and disputes are rare. The US Government in 1995 suspended Maldives' eligibility for tariff preferences under the US Generalized System of Preferences (GSP) because the Government failed to take steps to afford internationally recognized worker rights to Maldivian workers. The Government has drafted new labor laws dealing with rights of association, the right to organize, and acceptable conditions of work, and has promised to pass them into law. The US Government has offered technical assistance to review the draft legislation.

131. Foreign Investment: US firms represented in Maldives include Western Union, FedEx, UPS, Hewlett Packard (HP), Dell, Compaq, Coca-Cola, American Express, Hilton resorts, SeaTec, Ernst and Young, Price Waterhouse Coopers and KPMG.

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